

AMENDED IN ASSEMBLY SEPTEMBER 3, 2003

AMENDED IN ASSEMBLY JULY 10, 2003

AMENDED IN ASSEMBLY JUNE 19, 2003

AMENDED IN SENATE MAY 7, 2003

SENATE BILL

No. 640

Introduced by Senator Burton

February 21, 2003

An act to add ~~Article 11~~ *Chapter 1.5* (commencing with Section 10286) to ~~Chapter 1~~ of Part 2 of Division 2 of the Public Contract Code, *and to amend Section 25111 of, and to add Section 25113 to, the Revenue and Taxation Code*, relating to state contracts.

LEGISLATIVE COUNSEL'S DIGEST

SB 640, as amended, Burton. Public contracts: expatriate corporations.

The State Contract Act governs contracting between state agencies and private contractors, and sets forth requirements for the procurement of materials, supplies, equipment, and services by state agencies. Existing law sets out the various responsibilities of the Department of General Services, and other state agencies in overseeing and implementing state contracting procedures and policies.

This bill would prohibit a state agency from entering into any contract with an expatriate corporation, as defined, or its subsidiary, unless certain conditions are met. This bill would also establish a state-mandated local program by establishing a new misdemeanor.

The Corporation Tax Law allows corporations to elect whether their income is determined on a "water's-edge" basis or on a worldwide

unitary basis. *The election to report income on a water's-edge basis is made by contract between the taxpayer and the Franchise Tax Board. The contract requirements allow no relief for errors, and do not allow the perfecting of invalid water's-edge elections. Electors who fail to comply with the contractual requirements for making a water's-edge election forfeit their water's-edge election, thereby causing their income to be determined on a worldwide unitary basis.*

This bill would revise water's-edge election procedures by, among other things, providing that elections made under current law may be terminated if requested by all members of a water's edge group of which an expatriate corporation, as defined, is a member. These provisions would only become operative under specified conditions related to the operation of another bill.

The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.

This bill would provide that no reimbursement is required by this act for a specified reason.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: yes.

The people of the State of California do enact as follows:

1 SECTION 1. The Legislature finds and declares all of the
2 following:

3 ~~(a) A number of publicly traded United States based companies~~
4 ~~are avoiding United States taxation and have diminished their~~
5 ~~shareholders' rights by reincorporating, in name only, in tax haven~~
6 ~~countries, including Bermuda and the Cayman Islands.~~

7 *(a) By reincorporating in tax haven countries, a number of*
8 *publicly traded United States based companies are avoiding their*
9 *fair share of California taxes and have undermined the interests*
10 *and rights of their shareholders.*

11 (b) An expatriate company is a United States based company
12 that has moved in name and on paper only to a tax haven country
13 and has no substantial business activities in the country of
14 reincorporation.

15 ~~(c) This practice, also known as "corporate expatriation," is~~
16 ~~part of a larger pattern of deceptive corporate practices that~~

1 ~~continues to undermine the faith and confidence of investors in the~~
2 ~~integrity of the financial markets.~~

3 ~~(d)~~

4 (c) When a company expatriates, its shareholders are generally
5 left without the opportunity to pursue derivative lawsuits and
6 without the ability to enforce legal judgments against the company
7 under the United States and California securities laws. Therefore,
8 matters relating to standard fiduciary duties of officers and
9 directors of the corporation may be less dutifully monitored or
10 controlled.

11 (d) Further, the shareholders of expatriate companies stand to
12 lose their rights to submit a shareholder proposal, inspect or
13 obtain copies of the company's corporate records, or approve a
14 sale, lease, or exchange of all or substantially all of the
15 corporation's assets. In some cases, an expatriate company may
16 significantly limit shareholder voting rights or dissenting
17 shareholders' appraisal rights.

18 (e) This diminution of shareholder rights is the result of the
19 corporate practice, known as 'corporate expatriation,' which is
20 part of a larger pattern of deceptive corporate practices and
21 accounting manipulation that continue to undermine the faith and
22 confidence of investors in the integrity of the financial markets.

23 (f) The State of California and many of its residents are invested
24 in various corporations, mutual funds, and pension plans.

25 (g) The state's investments and pension funds depend on
26 investor faith and confidence in the transparency, fairness, and
27 integrity of the markets.

28 ~~(e)~~

29 (h) A corporate reincorporation greatly impedes the state and
30 the state's pension funds in safeguarding shareholder rights and
31 the state's financial interests.

32 (i) Further, substandard corporate governance models and
33 accounting practices of an expatriate corporation may impede its
34 ability to do business with the state in a manner required by state
35 law and sound public contracting practices. At the same time, the
36 state's ability to enforce its contract rights or enforce judgments
37 against the expatriate corporation may be limited as the result of
38 corporate expatriation.

39 (j) Further, an expatriate corporation, by avoiding its fair
40 share of taxes, gains an unfair advantage over corporations that

1 *do not expatriate when competing for state contracts, and thereby,*
2 *undermines the competitive state bidding process.*

3 (k) It is, therefore, in the best interests of the state to restore
4 faith in corporate practices and in the nation's financial system. A
5 vital and valid public purpose is served by prohibiting the state
6 from doing business with publicly held expatriate companies.

7 ~~(f) state's financial system by safeguarding the rights of~~
8 *shareholders, protecting the state's pension funds and other state*
9 *investments, ensuring a fair business climate, and guaranteeing*
10 *that similarly situated companies doing business in the state pay*
11 *their fair share of taxes. Furthermore, the preservation of state*
12 *control over matters relating to procurement and expenditure of its*
13 *revenues, a vital and valid public purpose, is served by prohibiting*
14 *the state from doing business with publicly held expatriate*
15 *companies.*

16 (l) Accordingly, it is the intent of the Legislature that, absent
17 a compelling public interest, the state not enter into any agreement
18 or contract with any publicly held expatriate corporation.

19 SEC. 2. ~~Article 11 Chapter 1.5~~ (commencing with Section
20 10286) is added to Chapter 1 of Part 2 of Division 2 of the Public
21 Contract Code, to read:

22
23 ~~Article 11. California Taxpayer and Shareholder Protection~~
24 ~~Act of 2003~~
25
26

27 CHAPTER 1.5. CALIFORNIA TAXPAYER AND SHAREHOLDER
28 PROTECTION ACT OF 2003
29

30 10286. This ~~article~~ chapter shall be known and may be cited
31 as the California Taxpayer and Shareholder Protection Act of
32 2003.

33 10286.1. (a) ~~Except~~ For purposes of this part, except as
34 otherwise provided in subdivisions (b) and (c), ~~the state~~ a state
35 agency may not enter into any contract with an expatriate
36 corporation or its subsidiaries.

37 (b) (1) For purposes of this article, an "expatriate
38 corporation" means a foreign incorporated entity that is publicly
39 traded in the United States to which all of the following apply:

1 (A) The United States is the principal market for the public
2 trading of the foreign incorporated entity.

3 (B) The foreign incorporated entity has no substantial business
4 activities in the place of incorporation ~~as compared to the business~~
5 ~~activity of its subsidiary or subsidiaries.~~

6 (C) Either clause (i) or clause (ii) applies:

7 (i) The foreign entity was established in connection with a
8 transaction or series of related transactions pursuant to which (I)
9 the foreign entity directly or indirectly acquired substantially all
10 of the properties held by a domestic corporation or all of the
11 properties constituting a trade or business of a domestic
12 partnership or related foreign partnership, and (II) immediately
13 after the acquisition, more than 50 percent of the publicly traded
14 stock, by vote or value, of the foreign entity is held by former
15 shareholders of the domestic corporation or by former partners of
16 the domestic partnership or related foreign partnership. For
17 purposes of subclause (II), any stock sold in a public offering
18 related to the transaction or a series of transactions is disregarded.

19 (ii) The foreign entity was established in connection with a
20 transaction or series of related transactions pursuant to which (I)
21 the foreign entity directly or indirectly acquired substantially all
22 of the properties held by a domestic corporation or all of the
23 properties constituting a trade or business of a domestic
24 partnership or related foreign partnership, and (II) the acquiring
25 foreign entity is more than 50 percent owned, by vote or value, by
26 domestic shareholders or partners.

27 (iii) For purposes of this subparagraph, indirect acquisition of
28 property includes the acquisition of a stock share, or any portion
29 thereof, of the owner of that property.

30 (2) Notwithstanding subdivision (a), ~~the state~~ *a state agency*
31 may contract with an expatriate corporation, or its subsidiary, if it
32 was an expatriate corporation before January 1, 2004, to which
33 both of the following apply:

34 (A) The foreign entity provides, by operation of law, by
35 provisions of its governing documents, by resolution of its board
36 of directors, or in any other manner, at least the following
37 shareholders' rights:

38 (i) Shareholders of the entity have the right to inspect, at a
39 principal place of business in the United States, copies of the
40 entity's books and records, including, but not limited to,

1 shareholder names, addresses, and shareholdings in accordance
2 with the corporation law, as amended from time to time and as that
3 law is interpreted by the courts, of the United States jurisdiction
4 in which the entity was previously incorporated, or, if the entity
5 was not previously incorporated, in accordance with the terms set
6 forth in the Model Business Corporation Act, as that act may be
7 amended from time to time, provided that, if the corporate law of
8 the United States jurisdiction in which the entity was previously
9 incorporated or the Model Business Corporation Act does not
10 provide access to the shareholder names, addresses, and
11 shareholdings, these books and records are available for inspection
12 by shareholders for purposes properly related to their status as
13 shareholders of the entity.

14 (ii) The entity permits its shareholders to bring derivative
15 proceedings on behalf of the entity, provided that these derivative
16 proceedings are brought on a basis and under the terms applicable
17 under the law, as amended from time to time and as interpreted by,
18 or required by, the courts of the United States jurisdiction in which
19 the entity was previously incorporated, or, if the entity was not
20 previously incorporated, on a basis and under the terms set forth
21 in the Model Business Corporations Act as that act may be
22 amended from time to time and as it is interpreted by, or required
23 by, the courts.

24 (iii) Entity transactions in which any director is interested are
25 approved in accordance with the applicable law, as amended from
26 time to time and as interpreted by the courts, of the United States
27 jurisdiction in which the entity was previously incorporated, or, if
28 the entity was not previously incorporated, in accordance with the
29 terms set forth in the Model Business Corporations Act, as may be
30 amended from time to time and as interpreted by the courts.

31 (iv) The entity has consented to the jurisdiction, for any
32 otherwise available cause of action by or on behalf of the entity's
33 shareholders, including any pendent state causes of action, of all
34 of the following courts:

35 (I) The state courts of one or more states.

36 (II) The United States federal courts in any state in which the
37 entity consents to the jurisdiction of that state's courts pursuant to
38 subclause (I).

39 (v) The entity has appointed an agent for service of process in
40 the state or states in which the entity has consented to jurisdiction,



1 as described in clause (iv), and the entity meets at least one of the
2 following conditions:

3 (I) The entity has unencumbered assets in the United States,
4 which assets may include equity or debt investments in United
5 States companies, with a book value in excess of fifty million
6 dollars (\$50,000,000), and the entity delivers to the Secretary of
7 State an opinion of an attorney licensed in the United States that
8 judgments rendered against the entity may be satisfied by using
9 these assets.

10 (II) The entity posts a bond or similar security in an amount of
11 at least fifty million dollars (\$50,000,000).

12 (III) The entity has directors' and officers' insurance in an
13 amount of at least fifty million dollars (\$50,000,000).

14 (vi) The entity agrees that, in connection with any lawsuit
15 brought against it by its shareholders in any court in which the
16 entity has consented to jurisdiction as described in clause (iv), the
17 entity will provide to the court notice of the manner in which the
18 entity complied with clause (v) and, if the entity complied with that
19 clause in the manner specified in subclause (I) of clause (v), a copy
20 of the opinion described in that subclause.

21 (vii) Shareholder approval is required for any sale of all or
22 substantially all of the entity's assets in accordance with the law,
23 as amended from time to time and as it is interpreted by the courts,
24 of the United States jurisdiction in which it was previously
25 incorporated, or, if it was not previously incorporated, in
26 accordance with the terms set forth in the Model Business
27 Corporations Act, as it may be amended from time to time.

28 (viii) The directors and officers of the entity occupy a fiduciary
29 relationship with the entity and its shareholders and these directors
30 and officers, in performing their duties, act in good faith in a
31 manner that a director or officer believes to be in the best interests
32 of the entity and its shareholders, as that standard of care is
33 interpreted by the courts.

34 (ix) The entity agrees to hold no more than one of every four
35 annual shareholder meetings in a location outside the United States
36 and, in the event that the entity holds an annual meeting outside the
37 United States, the entity agrees to provide access to that meeting
38 through a Web cast or other technology that allows the entity's
39 shareholders to do both of the following:

40 (I) Listen to the meeting, watch the meeting, or both.



(II) Send questions that will be addressed at the meeting.

(x) The entity provides a description of the shareholder rights described in clauses (i) to (ix), inclusive, and any subsequent changes to these rights, on the entity's Web site or in its 10K filings with the United States Securities and Exchange Commission.

(B) The entity uses worldwide combined reporting to calculate the income on which it pays taxes to the state.

(c) The chief executive officer of a state ~~department or~~ agency or his or her designee may waive the prohibition specified in subdivision (a) if the executive officer or his or her designee has made a written finding that the contract is necessary to meet a compelling public interest. For purposes of this section, a "compelling public interest" includes, but is not limited to, ensuring the provision of essential services, ensuring the public health and safety, or an emergency as defined in Section 1102. If a waiver is granted to a vendor pursuant to this subdivision, the requirement to submit a declaration of compliance, as set forth in ~~subparagraph (A) of paragraph (1) of subdivision (d)~~, does not apply to that vendor.

~~(d) (1) (A) From January 1, 2004, to December 31, 2004, inclusive, each vendor seeking to submit a bid to a state department or agency shall submit to the state department or agency with which it seeks to submit a bid a declaration that the vendor is not ineligible to contract with the state pursuant to this section.~~

~~(B) On or before January 1, 2005, and on or before January 1 of each subsequent year, each vendor seeking to submit a bid to a state department or agency shall submit a declaration to the Department of General Services that the vendor is not ineligible to contract with the state pursuant to this section.~~

(d) (1) For purposes of this chapter, "state agency" means every state office, department, division, bureau, board, commission, and the California State University, but does not include the University of California, the Legislature, the courts, or any agency in the judicial branch of government.

(2) On or after January 1, 2004, all state agencies shall, as a condition of the contract, require any vendor that is offered a contract to do business with the state to submit a declaration stating that the vendor is eligible to contract with the state pursuant to this section.

~~(2)~~

1 (3) A vendor that declares as true any material matter in a
2 declaration described in this subdivision that he or she knows to
3 be false is guilty of a misdemeanor.

4 (e) (1) Except as provided in paragraph (2), this section
5 applies to contracts that are entered into on or after January 1,
6 2004.

7 (2) With respect to an entity that was an expatriate corporation,
8 as defined in paragraph (1) of subdivision (b), before January 1,
9 2004, this section applies to contracts that are entered into on or
10 after April 1, 2004.

11 SEC. 3. *Section 25111 of the Revenue and Taxation Code is*
12 *amended to read:*

13 25111. (a) The making of a water's-edge election as provided
14 for in Section 25110 shall be made by contract with the Franchise
15 Tax Board in the original return for a year and shall be effective
16 only if every taxpayer that is a member of the water's-edge group
17 and which is subject to tax under this part makes the election. A
18 single taxpayer that is engaged in more than one business activity
19 subject to allocation and apportionment as provided in Article 2
20 (commencing with Section 25120) of Chapter 17 may make a
21 separate election for each business. The form and manner of
22 making the water's-edge election shall be prescribed by the
23 Franchise Tax Board. Each contract making a water's-edge
24 election shall be for an initial term of 84 months, except as
25 provided in subdivision (b). Each contract shall provide that on the
26 anniversary date of the contract or any other annual date specified
27 by the contract a year shall be added automatically to the initial
28 term unless notice of nonrenewal is given as provided in
29 subdivision (d). An affiliated corporation that is a member of the
30 water's-edge group and subsequently becomes subject to tax under
31 this part or is a nonelecting taxpayer that is subsequently proved
32 to be a member of the water's-edge group pursuant to a Franchise
33 Tax Board audit determination, as evidenced by a notice of
34 deficiency proposed to be assessed or a notice of tax change, shall
35 be deemed to have elected.

36 No water's-edge election shall be made for a taxable year
37 beginning prior to January 1, 1988.

38 (b) A water's-edge election may be terminated by a taxpayer
39 prior to the end of the 84-month period if either of the following
40 occurs:

1 (1) The taxpayer is acquired directly or indirectly by a
2 nonelecting entity which alone or together with those affiliates
3 included in its combined report is larger than the taxpayer as
4 measured by equity capital.

5 (2) (A) With the permission of the Franchise Tax Board.

6 (B) *The Franchise Tax Board shall consent to a termination*
7 *requested by all members of a water's-edge group, if the purpose*
8 *of the request is to permit the state to contract with an expatriate*
9 *corporation, or its subsidiary, pursuant to paragraph (2) of*
10 *subdivision (b) of Section 10286.1 of the Public Contract Code. A*
11 *water's-edge election terminated pursuant to this subparagraph*
12 *shall, however, be effective for the year in which the expatriate*
13 *corporation, or its subsidiary, enters into the contract with the*
14 *state.*

15 (c) In granting a change of election, the Franchise Tax Board
16 shall impose any conditions that are necessary to prevent the
17 avoidance of tax or to clearly reflect income for the period the
18 election was, or was purported to be, in effect. These conditions
19 may include a requirement that income, including dividends paid
20 from income earned while a water's-edge election was in effect,
21 which would have been included in determining the income of the
22 taxpayer from sources within and without this state pursuant to
23 Section 25101 but for the water's-edge election shall be included
24 in income in the year in which the election is changed.

25 (d) If the taxpayer desires in any year not to renew the election,
26 the taxpayer shall serve written notice of nonrenewal upon the
27 board at least 90 days in advance of the annual renewal date.
28 Unless that written notice is provided to the board, the election
29 shall be considered renewed as provided in subdivision (a).

30 (e) If the taxpayer serves notice of intent in any year not to
31 renew the existing water's-edge election, that existing election
32 shall remain in effect for the balance of the period remaining since
33 the original election or the last renewal of the election, as the case
34 may be.

35 *SEC. 4. Section 25113 is added to the Revenue and Taxation*
36 *Code, to read:*

37 *25113. (a) Except as provided in subdivision (f), for taxable*
38 *years beginning on or after January 1, 2003, the election provided*
39 *for in Section 25110 shall be made on an original, timely filed*

return for the year of the election. The election will be considered valid if both of the following conditions are satisfied:

(1) The tax is computed in a manner consistent with a water's-edge election.

(2) A written notification of election is filed with the return on a form prescribed by the Franchise Tax Board. Pursuant to regulations promulgated under this section, the Franchise Tax Board may accept the filing of other objective evidence that supports the conclusion that a water's-edge election was intended in lieu of notification on the designated form.

(b) Except as otherwise provided, a water's-edge election shall be effective only if made by every member of the self-assessed combined reporting group that is subject to taxation under this part.

(1) An election made on a group return of a self-assessed combined reporting group shall constitute an election by each taxpayer member included in that group return, unless one of those taxpayers files a separate return in which no election is made and paragraph (2) does not apply.

(2) A taxpayer that fails to make an election on its own timely filed original return shall be deemed to have elected if either of the following applies:

(A) It has a parent corporation that is an electing taxpayer that included the income and apportionment factors of the nonelecting taxpayer in the self-assessed combined reporting group reflected in the electing parent's timely filed original return, including a group return.

(B) The income and apportionment factors of the nonelecting taxpayer are reflected in the self-assessed combined reporting group of a timely filed original return of an electing taxpayer, and the notification of election filed by the electing taxpayer pursuant to paragraph (2) of subdivision (a) is signed by an officer or other authorized agent of either a parent corporation of the nonelecting taxpayer or another corporation with authority to bind the nonelecting taxpayer to an election.

(3) For purposes of this subdivision, a "parent corporation" of the taxpayer is a corporation that owns or constructively owns stock possessing more than 50 percent of the voting power of the taxpayer as determined under subdivisions (e) and (f) of Section 25105.

1 (4) If a corporation that is a member of a combined reporting
2 group is not itself subject to taxation under this part in the year for
3 which the water's-edge election is made, but subsequently
4 becomes subject to taxation under this part, that corporation shall
5 be deemed to have elected with the other taxpayer members of the
6 combined reporting group.

7 (5) A taxpayer that is engaged in more than one apportioning
8 trade or business as defined in paragraph (6) of subdivision (d) of
9 Section 25128 may make a separate election for each apportioning
10 trade or business.

11 (c) A water's-edge election shall remain in effect or be
12 terminated in accordance with this subdivision.

13 (1) Except as otherwise provided in this subdivision, if one or
14 more electing taxpayer members of a combined reporting group
15 later become disaffiliated or otherwise cease to be included in the
16 combined reporting group, the water's-edge election shall remain
17 in effect as to both the departing taxpayer members and any
18 remaining taxpayer members.

19 (2) If an electing taxpayer and a nonelecting taxpayer become
20 members of a new unitary affiliate group, the nonelecting taxpayer
21 shall be deemed to have elected if the value of the total business
22 assets of the electing taxpayer, and its component unitary group,
23 if any, is larger than the value of the total business assets of the
24 nonelecting taxpayer, and its component unitary group, if any.
25 Otherwise, the water's-edge election shall be automatically
26 terminated at the time the electing members become part of the
27 combined report. For purposes of applying paragraphs (9) and
28 (10), the commencement date of the deemed election shall be the
29 same as the commencement date of the electing taxpayers.

30 (3) If taxpayers filing under water's-edge elections with
31 different commencement dates become members of a new unitary
32 affiliate group, the earliest election date shall be deemed to apply
33 to all electing taxpayers if the total business assets of the earlier
34 electing taxpayer, and its component unitary group, if any, is larger
35 than the value of the total business assets of the later electing
36 taxpayer, and its component unitary group, if any. Otherwise, the
37 later election commencement date shall apply to all electing
38 taxpayers.

39 (4) (A) If a taxpayer with an election that has been terminated
40 under paragraph (9) or (10) becomes a member of a new unitary



1 affiliate group that includes another electing or nonelecting
2 taxpayer not affected by those paragraphs, any water's-edge
3 election of the other taxpayer member, if applicable, shall
4 terminate, and any restrictions on making a new water's-edge
5 election, relating to an election terminated under those
6 paragraphs, shall apply to all taxpayer members of the new unitary
7 affiliate group if the total business assets of the taxpayer with the
8 terminated election, and its component unitary group, if any, is
9 larger than the other taxpayer, and its component unitary group,
10 if any. Otherwise, paragraph (2) shall apply, if applicable. If
11 paragraph (2) does not apply, all taxpayer members of the new
12 unitary affiliate group will be treated as nonelecting taxpayers that
13 are not subject to any restrictions on making a new water's-edge
14 election.

15 (B) If two nonelecting taxpayers with different termination
16 dates under paragraph (9) or (10) become members of a new
17 unitary affiliate group, the earliest termination date shall be
18 deemed to apply to all nonelecting taxpayers, as well as any
19 restrictions on making a new water's-edge election relating to that
20 termination, if the total business assets of the earlier terminating
21 taxpayer, and its component unitary group, if any, is larger than the
22 value of the total business assets of the later terminating taxpayer,
23 and its component unitary group, if any. Otherwise, the later
24 termination date, and the related restrictions on making a new
25 water's-edge election, shall apply to all taxpayer members of the
26 new unitary affiliate group.

27 (5) (A) Except as provided in subparagraph (B), if one or more
28 electing taxpayers did not report their income and apportionment
29 factors as members of a combined reporting group with one or
30 more nonelecting taxpayers, and, pursuant to a Franchise Tax
31 Board audit determination, the nonelecting taxpayers, are
32 properly in the same combined reporting group as the electing
33 taxpayers, the water's-edge election of the electing taxpayers shall
34 remain in effect and the nonelecting taxpayers shall be deemed to
35 have made a water's-edge election. The commencement date of the
36 deemed water's-edge election shall be the same as the
37 commencement date of the electing taxpayers.

38 (B) Subparagraph (A) may not apply if the value of total
39 business assets of the electing taxpayers does not exceed the value
40 of total business assets of the nonelecting taxpayers. In that event,



1 *the water's-edge election of each electing taxpayer is terminated*
2 *as of the date the nonelecting taxpayers are, pursuant to the audit*
3 *determination described in subparagraph (A), properly included*
4 *in the same combined reporting group as the electing taxpayers.*

5 *(C) For purposes of applying the business asset test of this*
6 *paragraph, the term "business assets" shall have the same*
7 *meaning as subparagraph (A) of paragraph (6), except that the*
8 *business assets of other members of the unitary affiliate group that*
9 *are not taxpayers shall not be taken into account.*

10 *(D) Notwithstanding subparagraph (A), nonelecting taxpayers*
11 *may not be deemed to have made a water's-edge election if the*
12 *Franchise Tax Board audit determination described in*
13 *subparagraph (A) is withdrawn or otherwise overturned.*

14 *(6) For purposes of paragraphs (2) to (5), inclusive, the*
15 *following shall apply:*

16 *(A) "Business assets" are assets, including intangible assets,*
17 *other than stock of a member of the unitary affiliate group, which*
18 *are used in the conduct of the business of the unitary affiliate group*
19 *or would produce business income to the unitary affiliate group,*
20 *if an election were not in place, if the assets were sold. Business*
21 *assets shall be valued at net book value.*

22 *(B) The phrase "unitary affiliate group" refers to all of those*
23 *corporations that would constitute a unitary group if a*
24 *water's-edge election were not made.*

25 *(C) The phrase "new unitary affiliate group" refers to a unitary*
26 *affiliate group that is created by a new affiliation of two or more*
27 *corporations, or by the addition of one or more new members to*
28 *an existing unitary affiliate group.*

29 *(D) The phrase "component unitary group" means that portion*
30 *of a group of corporations that have become members of a new*
31 *unitary affiliate group that were members of their own respective*
32 *unitary affiliate group prior to entering the new unitary affiliate*
33 *group, disregarding any corporations that did not become part of*
34 *the new unitary group.*

35 *(7) In the application of paragraphs (2) to (4), inclusive, a*
36 *series of acquisitions as steps of a single transaction shall be*
37 *aggregated as a single change of membership.*

38 *(8) In the event of a merger or consolidation, the water's-edge*
39 *status and election commencement date or termination date of the*
40 *surviving corporation shall be consistent with the result that would*

1 have been obtained under paragraphs (2) to (4), inclusive, if the
2 surviving corporation had acquired the stock of the transferor
3 corporation.

4 (9) A water's-edge election may be terminated without the
5 consent of the Franchise Tax Board after it has been in effect for
6 at least 84 months. The termination shall be made on an original,
7 timely filed return for the first year in which the water's-edge
8 election is to be terminated. To be effective, the termination shall
9 be made by every taxpayer that is a member of the water's-edge
10 group in the same manner as the election provided under
11 subdivisions (a) and (b).

12 (10) A water's-edge election may be terminated before the
13 84-month period described in paragraph (9) has elapsed, but only
14 with the consent of the Franchise Tax Board. A request for
15 termination shall be made at the time and in the manner specified
16 by the Franchise Tax Board.

17 (A) The request may be granted for good cause. For purposes
18 of this section, good cause shall have the same meaning as
19 specified in Treasury Regulations Section 1.1502-75(c).

20 (B) The Franchise Tax Board shall consent to a termination
21 requested by all members of a water's-edge group, if the purpose
22 of the request is to permit the state to contract with an expatriate
23 corporation, or its subsidiary, pursuant to paragraph (2) of
24 subdivision (b) of Section 10286 of the Public Contract Code. A
25 water's-edge election terminated pursuant to this subparagraph
26 shall, however, be effective for the year in which the expatriate
27 corporation, or its subsidiary, enters into the contract with the
28 state.

29 (11) Except for deemed elections as provided in paragraphs
30 (2), (4), and (5), if a water's-edge election is terminated under
31 paragraph (9) or (10), another election may not be made under
32 this section for any taxable year that begins within the 84-month
33 period following the last day of the election period that was
34 terminated. The Franchise Tax Board may waive the application
35 of this prohibition period for good cause.

36 (12) A water's-edge election shall remain in effect until
37 terminated.

38 (d) For purposes of this section, the following shall apply:

39 (1) A "combined reporting group" means those corporations
40 whose income and apportionment factors are properly considered

1 pursuant to this chapter in computing the income of the individual
2 taxpayer that is derived from or attributable to sources within this
3 state, taking into account a valid water's-edge election.

4 (2) A "group return" refers to the single return which taxpayer
5 members of a combined reporting group may elect by contract to
6 file, in the form and manner prescribed by the Franchise Tax
7 Board, in lieu of filing their own respective returns.

8 (3) A "self-assessed combined reporting group" means that
9 group of corporations whose income and apportionment factors
10 are reflected in a combined report prepared pursuant to this
11 chapter in a timely filed return, taking into account the effects of
12 a purported water's-edge election, whether or not the membership
13 of the corporations in that combined report was correctly
14 determined.

15 (e) The Franchise Tax Board may prescribe any regulations as
16 may be necessary or appropriate to carry out the purposes of this
17 section.

18 (f) To the extent that a taxpayer would have been required to file
19 on a water's-edge basis in its first taxable year beginning on or
20 after January 1, 2003, pursuant to a water's-edge election made
21 in a prior year under Section 25111, the terms of Section 25111 may
22 not apply and the election shall be deemed to have been made
23 under the terms of this section. However, the commencement date
24 of the election made in a prior year under Section 25111 shall
25 continue to be treated as the commencement date of the
26 water's-edge election period for purposes of applying this section.

27 SEC. 5. It is the sole intent of the Legislature in enacting
28 Section 4 of this act to ensure that essential conforming changes
29 are made with respect to the termination of the water's-edge
30 election of an expatriate corporation, should SB 1061 be enacted
31 to add Section 25113 of the Revenue and Taxation Code with
32 respect to those elections.

33 SEC. 6. Section 3 of this bill shall not become operative if SB
34 1061 is enacted and amends Section 25111 of the Revenue and
35 Taxation Code.

36 SEC. 7. Section 4 of this bill shall only become operative if (1)
37 this bill and SB 1061 are enacted and become effective on or before
38 January 1, 2004, (2) SB 1061 adds Section 25113 to the Revenue
39 and Taxation Code, and (3) this bill is enacted after SB 1061, in
40 which case Section 25113 of the Revenue and Taxation Code, as



1 *added by SB 1061, shall remain operative only until the operative*
2 *date of this bill, at which time Section 4 of this bill shall become*
3 *operative.*

4 *SEC. 8.* No reimbursement is required by this act pursuant to
5 Section 6 of Article XIII B of the California Constitution because
6 the only costs that may be incurred by a local agency or school
7 district will be incurred because this act creates a new crime or
8 infraction, eliminates a crime or infraction, or changes the penalty
9 for a crime or infraction, within the meaning of Section 17556 of
10 the Government Code, or changes the definition of a crime within
11 the meaning of Section 6 of Article XIII B of the California
12 Constitution.

